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International Oil Developments

Special Issue:

Developments Since 1973 Oil Embargo

Secret

ER IOD 75-41
16 October 1975

Over the next two months the posted price of crude varied with the changing value of the dollar, according to an agreement - Geneva II - made earlier in the year between OPEC and the oil companies. A basket of 16 major currencies was used to calculate the dollar price for OPEC oil. The OPEC states had insisted on this arrangement to insulate themselves from dollar depreciation.

Oil Prices Skyrocket

The largest oil price increase in history took effect on 1 January 1974, as a result of decisions made at the December meeting of OPEC ministers in Tehran. The increase in posted price - from \$5.04 to \$11.65 - came about primarily through efforts of the Shah of Iran. The Shah, in need of money for his development and military programs, argued that the price of oil should rise because (a) such a move would immediately improve the revenue and balance-of-payments positions of OPEC members, (b) oil was being wasted by consuming countries at the prices then prevailing, and (c) oil is a non-renewable resource that would soon run out. The Iranian delegation calculated that alternative sources of energy would cost at least \$7.00 per barrel and convinced the other members to boost posted prices sufficiently to raise the cost of company-owned oil to this level.

By pushing through a posted price of \$11.65 per barrel, the Shah raised the average cost of oil not to \$7.00 per barrel as he was telling the press, but to \$8.04 per barrel, an increase of 126%. This higher figure resulted because the Shah's \$7.00 calculation had ignored government-owned participation oil, which was being sold back to the companies at a far higher price (93% of posted) than company-owned crude. With government participation in Saudi Arabia set at 25% in late 1972, the average cost of Saudi benchmark to the operating companies - both equity and buyback - jumped to \$8.04.

The OPEC states also agreed at Tehran to abandon the Geneva II automatic adjustment mechanism for oil payments. Under that system, they had witnessed a rise in the dollar relative to the 16 currency marketbasket and, consequently, a decline in posted prices. OPEC has since been very reluctant to adopt any similar formula.

In the spring of 1974, the Saudis publicly stated that the price of oil was too high, largely in an effort to place the onus of high prices on the Shah and others and to placate consuming countries. Riyadh shortly thereafter raised the prospect of a Saudi oil auction in which the companies would be allowed to bid